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Transfer of criminal liability in merger transactions: A major reversal of case law

In a fully reasoned ruling dated November 25, 2020, the Criminal Chamber of the *Cour de Cassation* (French Supreme Court) has reversed a case law that had been established for more than twenty years in "merger by acquisition" transactions (i.e., when a company is merged into another): The acquiring company may now, under certain conditions, be held criminally liable for an offence committed by the acquired company prior to the merger and for which it had not been convicted.

This is a landmark decision since the Criminal Chamber, which until then had equated the disappearance of a legal entity with the death of a natural person, had consistently held so far that the principle of personal criminal liability precluded such a transfer of liability.

In the case that led to this major reversal, a company accused of unintentional destruction by fire had been merged into another company during a "merger by acquisition" transaction before being summoned before the criminal court. The acquiring company, acting as the plaintiff in the appeal before the *Cour de Cassation*, argued that the principle of the personal nature of offences and penalties, set out in Article 121-1 of the French Criminal Code[1], precluded any criminal proceedings against it.

This argument, traditionally approved by French courts, was set aside by the Criminal Chamber in this landmark ruling. It should now be considered that a "merger by acquisition", which results in the universal

transfer of the acquired company's assets and liabilities to the acquiring company, also carries with it the transfer of criminal liability.

Given the magnitude of this ruling, the *Cour de cassation* was careful to state the reasons for its reversal.

Until then, the *Cour de Cassation* assimilated the winding up of a legal entity to the death of a natural person and consistently held that Article 121-1 of the French Criminal Code, according to which one can only be held criminally liable for his or her own actions, prevented the acquiring company from being prosecuted for acts committed by the acquired company prior to the merger transaction.

The Criminal Chamber now acknowledges that this position was unrelated to the economic reality and did not take into account the specificity of the legal entity which can change its form without being liquidated. Indeed, it reminds that while a "merger by acquisition" transaction entails the winding up of the acquired company, it does not result in its liquidation. Similarly, all of the assets and liabilities of the acquired company are transferred to the acquiring company. As a result, the economic activity carried out by the acquired company continues to be carried out in the acquiring company that completed the transaction.

This position is fully in line with the case law of the European Union.

Indeed, in a decision dated March 5, 2015[2], the Court of Justice of the European Union had already considered that the liability resulting from acts committed prior to the merger was transferred to the acquiring company as part of the assets and liabilities of the acquired company. However, this decision did not lead the *Cour de Cassation* to reconsider its position.

In a recent decision dated October 24, 2019[3], the European Court of Human Rights (ECHR), relying on the economic continuity that exists between the acquired company and the acquiring company, ruled that "*the imposition of a civil fine on an acquiring company for acts restricting competition committed by the acquired company prior to the merger does not infringe the principle of the personal nature of penalties*". It should be noted that in our internal legal system, the Commercial Chamber of the *Cour de Cassation* had already admitted on several occasions[4] the imposition of fines on the acquiring company for breaches of competition rules committed by the acquired company prior to the merger.

In its November 25, 2020 ruling, the Criminal Chamber of the *Cour de Cassation* applied the entire reasoning of the ECHR to justify its decision.

It thus recalled that the extinguishment of the acquired company's liability would contradict the very nature of the merger within the meaning of Directive 78/855/EEC of October 9, 1978 concerning mergers of public limited liability companies, which results in the transfer of all the assets and liabilities of the acquired company to the acquiring company, following a winding-up without liquidation. Furthermore, the transfer of liability complies with the principle of protection of third parties laid down by said Directive, without which a merger could be the means for a company to escape the consequences of the infringements it has previously committed, in disregard of the rights of creditors.

The contours of the transfer of criminal liability in "merger by acquisition" transactions are finally precisely defined by the Criminal Chamber of the *Cour de Cassation*.

As such, this transfer only applies to mergers that fall within the scope of the aforementioned Directive (see above) concerning mergers of public limited liability companies (*sociétés anonymes* in France), which also applies to simplified joint stock companies (*sociétés par actions simplifiées*).

Moreover, only fines and forfeiture are liable to be imposed, which excludes prohibition from exercising a professional activity or disbarment from public procurement.

Finally, the acquiring company will benefit from the same rights as the acquired company and may raise any defense that would have been available to the latter.

The principles outlined by the Criminal Chamber will apply to "merger by acquisition" transactions completed after November 25, 2020 as the application of such principles to merger transactions prior to that date would be contrary to the principle of predictability of penalties enshrined in the European Convention on Human Rights[5]. However, the *Cour de Cassation* specified that in case of fraudulent evasion of the law, i.e. if the purpose of the "merger by acquisition" transaction was to avoid the criminal liability of the acquired company, the judge may impose any criminal penalty, even if the transaction was completed before November 25, 2020.

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[1] Article 121-1 of the French Criminal Code: "*Any person is criminally liable only for his or her own actions*"

[2] CJEU, judgment of March 5, 2018, Modelo Continente Hipermercados SA c/ Autoridade para as Condiçoes de Trabalho, C-343/13

[3] ECHR, decision of October 24, 2019, Carrefour France c. France, n°37858/14

[4] Commercial Chamber of the *Cour de Cassation*, February 28, 2006, n° 05-12.138 – Commercial Chamber of the *Cour de Cassation*, January 21, 2014, n°12-29.166

[5] Article 7 of the European Convention on Human Rights: "*No one shall be held guilty of any criminal offence on account of any act or omission which did not constitute a criminal offence under national or international law at the time when it was committed. Nor shall a heavier penalty be imposed than the one that was applicable at the time the criminal offence was committed*".

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